



January 30, 2004

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
VIA EMAIL: regs.comments@federalreserve.gov

Re: Docket No. R-1167

Dear Board of Governors:

The Center for Responsible Lending (CRL) appreciates the opportunity to comment on the proposed changes to Regulation Z.

CRL is an organization dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. A nonprofit, non-partisan research and policy organization, CRL promotes responsible lending practices and access to fair terms of credit for low-wealth families. As part of a coalition with member organizations representing over three million North Carolinians, CRL was instrumental in helping to pass North Carolina's comprehensive statute against predatory lending. CRL continues to promote legislative and regulatory efforts to address predatory lending issues. CRL is also an affiliate of Self-Help, one of the nation's largest nonprofit community development lenders. Self-Help has provided more than \$2.6 billion in financing to help low-wealth borrowers in forty-eight states buy homes, build businesses, and strengthen community resources. The affiliation between the organizations provides CRL with important insight into the needs and responsibilities of lenders.

The Board of Governors of the Federal Reserve (the "Board") has recommended a number of revisions to Regulation Z and the associated Official Staff Interpretations set forth in Supplement I thereto (the "staff commentary"). Below, CRL addresses the proposed substantive changes in turn.

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Clear and conspicuous standard. CRL commends the proposal to set forth a definition of “clear and conspicuous” in 12 C.F.R. § 226.2(a) that mirrors the standard used in Regulation P. Defining “clear and conspicuous” to mean that a disclosure is “reasonably understandable and designed to call attention to the nature and significance of the information in the disclosure” targets the goal of disclosures more precisely than does the current definition. The concomitant revisions to the staff commentary likewise would clarify how the clear and conspicuous standard may be met. CRL approves of the use of the proposed standard in Regulations B (Docket No. R-1168), E (Docket No. R-1169), M (Docket No. R-1170) and DD (Docket No. R-1171) as well.

Numerical amounts. CRL likewise supports the interpretive rule proposed as new § 226.2(b)(5) clarifying that the word “amount” refers to a numerical amount. This change should avoid the result in Carmichael v. The Payment Center, Inc., 336 F.3d 636 (7th Cir. 2003), in which the court held that the disclosure of the amount of the last payment of the balloon loan in question as being “the balance of unpaid principal and interest to be paid in full” satisfied the requirements of TILA. By holding that the lender’s disclosure of the final payment amount did not have to be disclosed as a dollar amount, the court eviscerated TILA’s intent to provide meaningful information regarding the cost of consumer credit. In our experience, balloon loans often are given to unwitting consumers who cannot possibly make the balloon payment as an abusive means to push consumers subsequently to refinance into another loan with the lender, who then collects substantial up-front fees on the new transaction without providing any reasonable, tangible net benefit.

Further, CRL recommends that the proposed comment in Supplement I, ¶ 2(b)-2 be amended to require, rather than simply allow, disclosures provided before the first transaction under an open-end plan to state a percentage or dollar amount in explaining how the amount of a finance charge will be determined. Providing percentages and dollar amounts is the most clear and conspicuous means to convey the necessary information regarding the finance charge. By requiring, rather than simply permitting, the use of these formats, the Board would avoid having to revise the regulation in the wake of a Carmichael-like decision regarding an unclear or deceptive disclosure of information on determination of the finance charge.

Delivery of notice of rescission. The Board has recommended that ¶ 15(a)(2)-1 of the staff commentary be revised to provide that when a creditor fails to provide the consumer an address for notice and the consumer sends notice to a party other than the creditor or its assignee, state law will determine whether delivery to a third party constitutes delivery to the creditor or its assignee. CRL strongly recommends that the Board create a “safe harbor” provision for consumers that states that delivery of notice to the servicer of the loan in question constitutes notice to the holder.

The burden should be on a creditor or assignee who fails to provide an address for notice to arrange for the servicer to forward notices it receives, rather than on a consumer to investigate applicable state law regarding delivery of notice to a third party. This is

especially true given the limited three-day period TILA provides for exercise of the absolute rescission right.

Consumers do not have an effective way of determining the owner of their loan, which may change during an extended rescission period. Indeed, attorneys litigating cases frequently have difficulty discovering the true holder of a note. Borrowers generally only have contact with their loan servicer. State law may be ambiguous regarding whether, under the circumstances in question, notice delivered to a particular third party satisfied the notice requirement. A consumer should not be penalized for failing to give proper notice where state law is not clear. Further, borrowers should not have to obtain a lawyer to defend the adequacy of notice, given that the creditor has violated TILA's requirement that it provide an address for delivery of notice of rescission. A declaration that delivery of notice to the servicer constitutes delivery of notice to the holder, where the address for delivery of notice of rescission has not been provided, would avoid confusion, delay, and burdensome cost to consumers who attempt to exercise their rescission right.

Effect of Rescission. CRL agrees that Regulation Z should clarify that a consumer's substantive rescission right is not dependent on or altered by the procedures for the return of money or property or creditor acknowledgment of the release of its security interest, nor the modification of those procedures by a court. Such clarification is needed to counteract such decisions as made in Yamamoto v. Bank of New York, 329 F.3d 1167 (9th Cir. 2003). The Yamamoto court stated that, in a contested case, the security interest becomes void only when the court decides that the borrower has the right to rescind. See Yamamoto, 329 F.3d at 1172. Accordingly, the court held that a court could condition rescission on proof of a consumer's ability to tender. See id. at 1173. However, the plain language of 15 U.S.C. § 1635 makes clear that "[w]hen an obligor exercises his right to rescind under [15 U.S.C. § 1635(a)] . . . any security interest given by the obligor, including any such interest arising by operation of law, becomes void upon such a rescission." (Emphasis added.) Furthermore, decisions such as Yamamoto ignore the plain language of 12 C.F.R. § 226.15(d)(4). This regulation properly differentiates between the first sentence of 15 U.S.C. § 1635(b), which relates to the automatic effect of rescission, and the remaining sentences of that subsection, which set forth the procedures for return of money and property and for action to reflect the termination of the security interest after rescission. As made clear by 12 C.F.R. § 226.15(d)(4), only the tender procedures are subject to modification by a court.

Decisions that hold that courts may condition rescission on tender by the consumer disregard the fact that 15 U.S.C. § 1635(a) and (b) consciously reverse the common law requirement that tender precede rescission. The legislative history of 15 U.S.C. § 1635(b) shows that the committee intended that courts be permitted to impose equitable conditions "to insure that the consumer meets his obligations after the creditor has performed his obligations as required under the Act." See S. Rep. No. 368, 96th Cong., 2d Sess. at 29 (emphasis added). Clearly, the intent of Congress was not to prevent consumers from being able to fulfill their obligations, as would be the effect under the Yamamoto decision. It is critical, therefore, that the Board enforce the

sequence of events set forth in 12 C.F.R. § 226.15 in light of the actual circumstances consumers face. As the Board noted, consumers often need to establish their substantive right to rescind and to have the lien amount reduced before they are able to establish how they will refinance or otherwise repay the loan. Requiring borrowers to provide proof of their ability to tender prior to determination of the right to rescind would unduly privilege protection of creditors over protection of borrowers, whom the Truth in Lending Act was intended to benefit.

CRL supports the Board's goal of distinguishing between the automatic rescission effectuated by the consumer's delivery of notice and the post-rescission procedures that are subject to court modification. The Board's proposed language for ¶ 15(d)(4)-1 and ¶ 23(d)(4)-1 of Supplement I, however, is ambiguous. CRL recommends the addition of the underlined text: "The consumer's right to rescind under § 226.15(a)(1) and § 226.15(d)(1) is a substantive right rather than a procedure and is not subject to modification by a court. The right to rescind is independent of and is not affected by the procedures referred to in § 226.15(d)(2) and (3), or the modification of those procedures by a court." This revision more clearly addresses court decisions that reduce consumers' substantive rescission right to a mere procedure that is subject to court modification.

Language of Disclosures. Though the Board has indicated that its proposed change to the staff commentary regarding 12 C.F.R. § 226.27 is intended merely to conform the commentary to revisions previously made to § 226.27 and is not substantive, CRL opposes the change. Section 226.27 has been revised to permit disclosures to be made in a language other than English, as long as disclosures are available in English at the consumer's request. The proposed amendment to the staff commentary states that subsequent disclosures, including periodic statements and change-in-terms notices, do not have to be given in the other language. However, a creditor who initially makes disclosures to a consumer regarding a contract's terms in a non-English language should not be permitted to change the contract terms through a unilateral amendment written in English. Presumably, if a person needed initial disclosures to be in a language other than English, that person will need subsequent disclosures and notices to be in that non-English language in order to determine whether to accept the proposed terms. CRL recommends that subsequent material disclosures, as well as disclosures that materially affect the rights and remedies of the consumer (for example, prepayment penalty provisions) be in both English and the language in which the consumer received the initial disclosures.

Debt Cancellation and Debt Suspension Coverage.

Expanded Forms of Debt Cancellation and Debt Suspension Coverage. The Board has requested comments regarding debt cancellation coverage (DCC) and debt suspension coverage (DSC). DCC and DSC are functionally equivalent to credit insurance. CRL is concerned that the expansion of DCC and DSC for such events as marriage and divorce may reflect a desire to avoid increasingly precise restrictions on

credit insurance, including the financing thereof.¹ While CRL continues to support a ban on the financing of such products, CRL applauds the Federal Reserve's December 20, 2001 revisions to Regulation Z, which have made a significant difference to consumers. We urge the Federal Reserve to take steps to preserve the positive accomplishments leveraged from these amendments by revising 12 C.F.R. § 226.32(b)(1)(iv) to reflect that charges for such expanded forms of DCC and DSC are included among the fees that must be evaluated in the determination of whether a home loan is covered by the Home Ownership and Equity Protection Act of 1994 (HOEPA). All forms of credit insurance, DCC and DSC also should be included in the examples of finance charges set forth in 12 C.F.R. § 226.4(7) and (10).

Exemption for Certain Credit Insurance, DCC and DSC. Pursuant to 15 U.S.C. § 1605(b) and 12 C.F.R. § 226.4(d)(1) and (d)(3), as long as certain disclosures are made and the borrower signs or initials a request for coverage, credit insurance, DCC and DSC are exempt from the requirement that premiums for them be included as a finance charge. This exemption has failed to protect consumers and should be repealed for the same reasons as justify the inclusion of such products in HOEPA points and fees. The current exemption fails to acknowledge that credit insurance, DCC and DSC very frequently are pushed onto the consumer by creditors rather than requested by the consumer. Many borrowers are not told that such coverage is optional. Furthermore, lenders often include such coverage in the loan documents and do not disclose to borrowers that their loan balance includes the cost of such coverage until the borrower is at closing ready to sign the loan documents. High-pressure sales tactics or simply the flurry of documents they are told to sign frequently cause borrowers to sign documents for products they do not understand or desire. Borrowers who object to the inclusion of the coverage may be told that their loan will be delayed and will have to be reprocessed if the coverage were to be removed, with no guarantee that the new loan would be approved. Under such coercive circumstances, many borrowers understandably sign the documents simply to complete the loan transaction. Coverage for credit insurance, DCC and DSC should not be allowed exemption from inclusion in the finance charges, even under the circumstances set forth in 15 U.S.C. § 1605(b) and § 226.4(d).

CRL notes that 15 U.S.C. § 1605(b) refers specifically to insurance. The Federal Reserve has the authority to differentiate between credit insurance and DCC/DSC and to deny the latter the benefit of § 1605(b). Unlike credit insurance, DCC and DSC products generally are unregulated. Furthermore, their use may lead to tax liability for consumers. The additional risk associated with DCC and DSC, as well as the absence of a Congressional intent to treat these largely unregulated products in the same manner as credit insurance, justify their being denied the benefit of being exempt from inclusion in the finance charge calculation.

¹ As we have previously noted in remarks to the Board, while such products may be useful when the cost is calculated and paid in full on a monthly basis, adding such premiums into the home loan amount strips equity. When coverage is financed, homeowners pay interest on the premium for the life of the loan. The homeowner's obligation to pay remains even if coverage has ended. In the case of a home mortgage, if a borrower moves or refinances after coverage has ended, the financed premium is stripped directly out of the borrower's home equity.

Change of Insurers. CRL believes that 12 C.F.R. § 226.9(f) should be amended to address conversions from credit insurance to DCC/DSC products and vice versa. We also feel that the Board should address such conversions in contexts other than credit card accounts, particularly since DSC and DCC are generally unregulated and their utilization may lead to income tax liability to the consumer. Creditors should be required to disclose to consumers the potentially substantial loss of protections and income tax liability resulting from a conversion to DCC or DSC.²

Thank you for the opportunity to comment on these matters. Please do not hesitate to contact CRL if you would like to discuss these issues in greater detail.

Sincerely,

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² In addition, we encourage the Board to study the feasibility of switching from an opt-out system to an opt-in system with respect to changes in contractual terms between creditors and consumers.